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IN THE

Supreme Court of the United States

OCTOBER TERM 1980

WILLIAM H. MARX and FLORENCE MARX,
his wife, et al.,
Petitioners,

v.

COMPUTER SCIENCES CORPORATION,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. What constitutes "knowing misconduct" for purposes of meeting the scienter requirement under Section 10(b) and Rule 10b-5?
2. Is proof that a defendant had actual knowledge of negative facts, and that it intentionally decided not to disclose these facts, sufficient to meet the scienter requirement?

LIST OF PARTIES

Plaintiffs are WILLIAM H. MARX and FLORENCE MARX, husband and wife, WILLIAM H. MARX, JR., and the class of all persons who purchased stock of Computer Sciences Corporation between January 23, 1970, and April 2, 1970. Defendant is COMPUTER SCIENCES CORPORATION, a Nevada corporation.

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I.

OPINIONS OF COURTS BELOW

The Complaint was filed in October, 1970, alleging defendant Computer Sciences Corporation misled investors in violation of Section 10(b) and Rule 10b-5. The district court granted summary judgment for defendant. In November, 1974, the Ninth Circuit vacated the summary judgment and

remanded the case for trial. Marx v. Computer Sciences Corporation, 507 F.2d 485 (1974). The district court thereafter ordered that the issue of defendant's scienter be bifurcated from other issues and tried initially. Trial on the scienter issue occurred in February, 1977. On December 27, 1978, the trial court entered Amended Findings of Fact and Conclusions of Law, and Judgment for defendant, determining that although the defendant knowingly omitted facts, the omission was without scienter. Plaintiffs appealed to the Ninth Circuit. The history of the appeal is summarized in the following section. (The opinions of the district court and Ninth Circuit are in the Appendix hereto.)

II.

GROUNDS FOR JURISDICTION

Judgment for defendant was entered by the United States District Court for the

Central District of California on December 28, 1978. Appeal was timely filed by plaintiffs. A Memorandum Decision of the Ninth Circuit Court of Appeals affirming the judgment was filed September 8, 1980. Petition for Rehearing was timely filed by plaintiffs. An Order of the Ninth Circuit Denying Rehearing was filed on November 14, 1980. Plaintiffs file this Petition for Writ of Certiorari within 90 days of the Order denying the petition for rehearing pursuant to 28 U.S.C. § 2101(c) and Rule 20 of the Supreme Court Rules.

III.

STATUTES AND REGULATIONS INVOLVED

A. Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78J:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange--
>
> . . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

B. Rule 10b-5 of the Securities Exchange Commission, 17 C.F.R. 240.10b-5:

Employment of Manipulative and Deceptive Devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of a national securities exchange,

(1) to employ any device, scheme or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

IV.

STATEMENT OF THE CASE

Plaintiff brought this action in federal district court for violation of Section 10(b) of the Exchange Act of 1934 and Rule 10b-5 thereunder.

The defendant Computer Sciences Corporation (herein "CSC") is a publicly traded company. On January 23, 1970, Mr. William Hoover, President of defendant CSC, delivered an address about CSC to the New York Society of Security Analysts. Mr. Hoover, in consultation with other company executives, knowingly and intentionally omitted from the address numerous adverse facts about the company. These same negative adverse facts, which were knowingly omitted from the address, two months thereafter precipitated actions by the company which resulted in a sudden sharp decline in the price of the company's stock

and thereby damaged plaintiffs and members of the class.

CSC is engaged in the computer software and information sciences field. At the time of the address it had embarked upon a number of substantial proprietary developments. Among those developments were Computicket (herein "CT") and Infonet. Because of the significance of the proprietary developments to the welfare of the company, Mr. Hoover knew when he addressed the analysts that they would be interested equally in the financial condition of the company and in any problems which the company was experiencing with its proprietary developments (Appendix No. 7).

The address, which was also distributed to the media, was positive and optimistic in all respects (Appendix No. 5). Each of the proprietary developments were

portrayed as proceeding well and successfully. Mr. Hoover described the company as having both the technical skills and the financial ability to go forward with developments, including the expenditure of $100,000,000 in three years on a proprietary development, Infonet. The condition of the company was described in glowing terms and a forecast of earnings was made of $1.00 per share for the nearly ended fiscal year--earnings double those of the preceding year.

Contrary to the representations in the address, CSC was then experiencing serious problems both with CT and with its finances. Mr. Hoover and Company officials consciously decided not to disclose any of these problems. The lower court found:

> 11. At the time of the address, Hoover was aware of the facts which might bear upon the assertions, predictions and opinions contained in this speech. Among these were

> the facts that CT had not met all internal projections; that CT had lost First National City Bank as a prospective customer; that difficulties had been encountered in getting equipment operational and installed; that CSC had not procured capital to finance some proprietary products; and that CSC had considered selling one-half of its ownership of CT. He was also aware of the accounting treatment used for development costs of CT. [Finding 11, Appendix No. 1.]
>
> . . . .
>
> 25. At the time of the address, Hoover was aware of, but did not include in his speech, the facts discussed in these findings that related to his assertions, predictions and opinions about CSC . . .

The record supports each of the points referred to in the findings. It is replete with evidence of the undisclosed difficulties with CT. The difficulties with CT were so substantial and so apparent that the Ninth Circuit in its prior decision enumerated the difficulties with CT and after doing so stated:

> In short, the inference is plain that the likelihood of CT's commercial success became progressively

> more doubtful with the passage of time.

Marx v. Computer Sciences Corp., supra, at p. 489.

The problems with CT grew in magnitude during 1969. In the spring of 1969 the company had stated to shareholders in the annual report for fiscal year 1969 that CT was forecast to be initially profitable in fiscal 1970 (Appendix No. 6). (CSC operates on a fiscal year which ends in March. Thus fiscal year 1970 ended in late March, 1970.) Copies of the annual report to shareholders for 1969, without any amendment, were provided to the analysts who heard the speech. Instead of becoming profitable, CT's performance turned downward during the calendar year 1969. Its operating results reflected increasingly larger monthly losses which by the time of the address were at a monthly rate in excess of $600,000. On December 31, 1969

the company lost a customer, First National City Bank, which had been touted only nine months earlier as the nucleus of CT's eastern operation.

Each successive forecast prepared by the company during calendar 1969 further reduced projected revenues and further delayed the time when it was projected CT might become profitable. The forecast prepared on December 30, 1969, three weeks before the address projected losses for CT until 1973. At the time of the address, CT had generated losses in excess of $10,000,000. Total earnings for CSC in its entirety had never exceeded in any year more than $6,393,000.

CT's losses were not charged against CSC's income. Rather, they were capitalized and treated as an asset on CT's balance sheet. The company had informed investors in September, 1969, in a prospectus in connection with a convertible

debenture issue, however, that it would discontinue capitalization of CT losses and begin currently expensing its costs as of October 1, 1969. CSC did not make the announced accounting change but rather, continued to capitalize CT's losses.

CT's condition was so precarious that in December, 1969, management had discussed the possibility of abandoning CT.

The record also manifests undisclosed financial problems at the time of the address which if disclosed would have alerted investors to the debacle which occurred two months after the address. The company's banks had rejected CSC's requests in November, 1969 for a line of credit of $25,000,000. CSC's own internal projection showed a need for the money requested if it was to continue all of the proprietary developments then underway. No other source of funds had been located at the time of the address.

Two months after the address, CT was abandoned. Mr. Nutt, one of the company's directors, testified CT was abandoned because it was financially impossible for the company to go forward with the development of both CT and Infonet. In abandoning CT, the company wrote off capitalized expenses of CT. Mr. Hoover in his address specifically told analysts that such an appreciable write-down was not contemplated. The write-off cut in half the earning's prediction of Mr. Hoover's address.

The record does not indicate any change in the CT difficulties or in the financial difficulties between the time of the address and the abandonment of CT. All of CSC's difficulties were knowingly omitted by Mr. Hoover and CSC from his address to the investing public.

V.

ARGUMENT FOR ALLOWANCE OF WRIT

Plaintiff petitions for writ of certiorari for the following reasons:

1. This case raises an important question of federal law which has not been, but should be, settled; namely, what constitutes "knowing misconduct" for purposes of meeting the scienter requirement of Section 10(b) and Rule 10b-5.

2. The Supreme Court's decision in Ernst & Ernst v. Hochfelder, 425 U.S. 185, 96 S. Ct. 1375, 47 L. Ed. 2d 668 (1976) is unclear and has led to confusion in interpretation by lower courts. The decision by the Ninth Circuit in this case is in conflict with decisions of other lower courts on the scienter issue.

Ernst & Ernst v. Hochfelder, supra, held negligent conduct to be an insufficient basis for liability under Section

10(b) and Rule 10b-5. The opinion indicated that "scienter" was required. Various lower courts have commented on the requirement:

> Courts, and commentators alike have noticed, however, that, read as a whole, the Hochfelder opinion does not yield such a clear and ineluctable explication of the meaning of "scienter."

United States v. Chiarella, 588 F.2d 1358, 1370 (2d Cir. 1978).

> While the Court initially defined scienter as a "mental state embracing intent to deceive, manipulate or defraud," it seemed to limit this definition to the case before it. Id. 425 U.S. at 193-94 n. 12, 96 S. Ct. at 1381. Other language and reasoning in the opinion appear to contradict the court's initial and strict definition of scienter. For example, although it did not decide the issue, the Court recognized that, for purposes of satisfying the scienter requirement, "[i]n certain areas of the law recklessness is considered to be a form of intentional conduct for purposes of imposing liability for some act." Id. In addition, other language in the opinion reveals that the Court did no more than reject negligence as a basis of liability under Rule 10b-5, lending credence

> to the view that "knowing or intentional" misconduct satisfies the scienter requirement. Id. at 197, 198, 96 S. Ct. 1375.

In re Transocean Tender Offer Securities Litigation, 455 F. Supp. 999, 1009-1010 (D.C. Ill. 1978).

Some lower court opinions have interpreted Hochfelder to identify three alternative forms of scienter: (1) a mental state embracing intent to defraud; (2) reckless misconduct; and (3) knowing misconduct. In re Transocean, supra; Valente v. Pepsico, Inc., 454 F. Supp. 1228 (D.C. Del. 1978); Rochez Bros. Inc. v. Rhoades, 491 F.2d 402 (3d Cir. 1974). These three forms of scienter correspond to Professor Bromberg's conceptual criteria of liability: (1) state of mind criteria; (2) core criteria; and (3) knowledge criteria. Bromberg, Securities Law Fraud, Vol. 3, §§ 8.4(503) and 8.4(504),

pp. 204.103-106 (1971, 1979). See also Jacobs, The Impact of Rule 10b-5, 5 Securities Law § 63 (Rev. 1980).

Although some lower courts have distinguished three alternative forms of scienter, application of the criteria to specific fact patterns has increased confusion. Lower court opinions are split and confused over what constitutes "knowing misconduct". The uncertainty of direction is greatest in cases, like the one at hand, where there has been a knowing omission of fact.

Two of the necessary elements for liability in an omission case are clear: (1) there must be an omission of fact; (2) the omitted fact must be material and make statements made by the defendant misleading. Some lower court opinions hold that a defendant's knowing omission of fact is in and of itself sufficient scienter for

liability. In re Transocean, supra; Valente v. Pepsico, Inc., supra; Rochez Bros., Inc., supra; Herzfeld v. Laventhol, Krekstein, Horwath & Horwath, 540 F.2d 27 (2d Cir. 1976).

However, other lower court opinions, including the district court and Ninth Circuit in this case, hold that a defendant must additionally "know" the omitted fact to be material and misleading, or that he must act recklessly in regard to the danger of misleading a plaintiff. See also McLean v. Alexander, 599 F.2d 1190 (3d Cir. 1979), overruling, 420 F. Supp. 1057 (D.C. Del. 1976). Other lower court opinions which do not specifically reach the issue, may be read to support either position; however, the basic approach of these cases would make a knowing omission of fact sufficient in and of itself. See Nelson v. Serwold, 576 F.2d 1332 (9th Cir. 1978),

cert. denied, 439 U.S. 970 (1978); Spectrum Financial Companies v. Marconsult, Inc., 608 F.2d 377 (9th Cir. 1979), cert. denied, 48 U.S.L.W. 3733 (May 13, 1980); Sunstrand Corp. v. Sun Chemical Corp., 553 F.2d 1033 (7th Cir. 1977), cert. denied, 434 U.S. 875, 98 S. Ct. 224, 54 L. Ed. 2d 155 (1977); Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38 (2d Cir. 1978), cert. denied, 439 U.S. 1039, 99 S. Ct. 642, 58 L. Ed. 2d 698 (1978).

Proof that a defendant had actual knowledge of a fact and its omission is straightforward. It involves neither the defendant's state of mind nor a standard of care (negligence, recklessness, constructive knowledge) by which he should have known.

Knowledge of a misleading effect is markedly different than knowledge of a fact. Proof that a defendant knew the

misleading effect of his omission is proof of state of mind. One's knowledge that he is misleading another is the same thing as intent to mislead. See Bromberg, supra, § 8.4(522), p. 204.132. Since all courts appear to recognize recklessness as the functional equivalent of intent, proof of reckless conduct might be an alternative to proof of state of mind. Such proof would consist of extreme conduct so obviously involving a misleading effect that the defendant should--indeed must--have been aware of it.

Proof of defendant's knowledge of the misleading effect of his omission if required, would therefore necessitate proof of state of mind or recklessness. If this is necessary for liability under Hochfelder, then "knowing misconduct" as an independent form of scienter is eliminated as an alternative criteria. A plaintiff

must then prove either defendant's state of mind or his recklessness; and, thus, a defendant's knowing omission of fact is reduced in status to merely an evidentiary circumstance, without independent significance.

Lower court opinions that have accepted the foregoing have done so with little analysis or reasoning for their conclusion. The trial court and Ninth Circuit decisions in this case are examples. See also the Third Circuit's opinion in McLean v. Alexander, supra. On the other hand, other lower court opinions have specifically rejected state of mind or recklessness criteria. In Valenta v. Pepsico, Inc., supra, the court held at pp. 1251-1252:

> defendant's actual knowledge of undisclosed information . . . was sufficient to constitute knowing misconduct, and would thus sustain a finding of liability.

The court expressly rejected the defendants' argument:

> Defendants argue that an "actual knowledge" or "knowing conduct" standard requires not only knowledge of the omitted information, but also knowledge that the information will mislead investors. There is no indication in Rochez, supra, that the latter type of knowledge is required. Most securities cases which apply a standard of knowing conduct refer only to knowledge of the omitted information. See, 3 Bromberg, supra, § 8.4(521) at 204.131.

Valenta, supra, at p. 1252, Footnote 12, citing Rochez Bros., Inc. v. Rhoades.

Likewise, in In re Transocean, supra, the court held actual knowledge of omissions sufficient "irrespective of intent". The court stated at page 1010:

> The mere fact that the Delaware Supreme Court did not find that there was a specific intent to deceive or harm investors as a result of the deception is, as has been stated earlier, of no moment. Sundstrand Corp. v. Sun Chemical Corp., supra, at 1044 n. 16. Defendants' knowing and intentional conduct satisfies the scienter

> requirement. . . . Defendants, however, contend . . . that proof of scienter requires a showing "not only that the defendant consciously decided not to disclose the information, but also that the nondisclosure created an obvious danger of misleading buyers or sellers." . . . Defendants have misread Sundstrand and other post-Hochfelder authorities. . . . As the New York plaintiffs correctly note, where, as here, defendants concede that their conduct was knowing and deliberate, it is unnecessary to explore whether defendants' conduct was reckless. . . . Contrary to defendants' assertion, the demonstration that the nondisclosure created an obvious danger of misleading buyers or sellers is required only under the reckless aspect of the Sundstrand test.

The commentators also support the proposition that a knowing omission of fact is alone sufficient for liability.

> Knowing conduct is an alternative basis imposing liability. A plaintiff proving a knowing violation therefore does not have to prove that the defendant's acts created an obvious danger of misleading buyers or sellers.
>
> A defendant's actions constitute knowing conduct if he knew the truth concerning the misrepresented facts or is aware of the omitted data when

> the violation takes place. There is no requirement that the defendant also know that the information will mislead investors. He can obtain knowledge in a variety of ways. Actual knowledge is obviously sufficient. . . .

Jacobs, The Impact of Rule 10b-5, 5 Securities Law § 63, pp. 3-208 (Rev. 1980).

> Of the three classes of criteria (state of mind, care, knowledge), the knowledge class is, in my judgment, the most appropriate to use in 10b-5 private suits. . . .
>
> The state of mind criteria are subjective, calling often for intuitive or emotional findings of "fact". They have a moral element, carried forward from an age more concerned with morals. In consequence, they are imprecise and perhaps irrelevant tools to use on contemporary securities problems.
>
> Knowledge criteria and care criteria have common advantages over state of mind criteria in the respects just noted. They are more objective. . . . And they call less openly for moral judgments, thereby giving reason to hope for more uniform application.
>
> Knowledge standards are better than care standards for use in 10b-5 cases on several counts. (1) Knowledge standards are more attuned to what securities fraud is now

> mainly about: information . . . (2) Knowledge standards are the basic criteria in the express liability fraud provisions. . . . (3) Knowledge criteria are probably easier for juries to grasp. . . . (4) Care standards, because of their tort law source, create conceptual antagonisms which are unnecessary and perhaps misleading.

(Citations to authorities and treatise sections omitted.) Bromberg, supra, at § 8.4 (504), pp. 204.104-106.

A defendant who knowingly omits facts has sufficient "scienter" for liability. A knowing omission embraces both knowledge of the facts and an intent to omit them. The "level of conscious attention" of the defendant "meets as a matter of law the scienter requirement of Hochfelder." Sundstrand Corp., supra, at p. 1044.

In the case at hand the defendant had actual knowledge (1) that there were negative facts about its operations, (2) that these facts were omitted from its

statements, and (3) that securities analysts and the investing public did not know or have access to these facts. The defendant (4) was not oblivious to the consequences or dangers of omitting the facts, and (5) knew analysts would be concerned with such negative facts over and above an earnings forecast. Nevertheless the defendant intentionally decided (6) that the negative facts were not relevant, (7) that an omission did not make its statements misleading, and (8) that the negative facts would not be disclosed.

There are many "states of mind" embracing reasons that might motivate a defendant to intentionally omit negative facts: (1) to defraud, deceive, or mislead; (2) to give plaintiff a "bad time"; (3) to avoid questions about negative facts; (4) to prevent "second opinion" or "second guessing" of defendant's evaluation

of the facts; (5) for the sake of brevity; or for whatever conscious reason. In the case at hand, the trial court found defendant had no intent to defraud. Other lower court opinions recognize that such specific intent is not necessary to liability.

> Indeed, such fraudulent intent was not required by any of the cases or commentators cited by the Hochfelder court as favoring a scienter requirement in 10b-5 actions, . . . nor was it generally required at common law.

(Citations omitted.) United States v. Chirarella, supra, at pp. 1370-1371.

> To require in all types of 10b-5 cases that a factfinder must find a specific intent to deceive or defraud would for all intents and purposes disembowel the private cause of action under § 10(b).

Rolf v. Blythe, Eastman Dillon & Co., Inc., supra, at p. 47.

The trial court in the case at hand says nothing at all about other possible

states of mind. The trial court's discussion is superficial. Reasonable men can disagree on evaluations and predictions from the same set of facts; what is a significant fact to one may be insignificant to another. We can judge two different conclusions or predictions to be made in good faith and to be "not unreasonable". But when one man withholds facts from another, so that the latter is unable to draw his own conclusions on those facts, then such conduct is culpable as scienter. This is certainly so when they are related as seller and buyer or as issuer and investor. The seller's or issuer's specific state of mind is irrelevant.

Because of the trial court's bifurcation of issues, neither the trial court nor the Ninth Circuit made a determination of the materiality of the omitted facts. The test of materiality is an objective one:

whether or not there is a substantial likelihood the omitted facts would be important to a reasonable investor in making an investment decision. TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 96 S. Ct. 2126, 48 L. Ed. 2d 757 (1976); Herzfeld v. Laventhol, supra. Materiality is thus concerned with the buyer's reaction to the facts, not with that of the seller, issuer, or broker. Materiality is a standard for judging the plaintiff investor, not the defendant issuer. If the plaintiff investor's conduct is to be judged, it should be done by the court.

In the case at hand, no judgment of materiality was made by the court. But such judgment was made! It was made by the defendant. In effect, the defendant consciously made a finding that the negative facts were not material to investing

buyers. We thus have the defendant making the judgment on what facts are significant to investors. One side to the transaction has made a decision for the other side of the transaction. The defendant is the judge of the plaintiffs' interest.

And, in the case at hand, the defendant's judgment on the plaintiff's interest has in the omitted negative facts been declared final by the trial court and Ninth Circuit. This is wrong.

A major purpose of the securities laws is to ensure the flow of information from securities sellers and issuers, on one side of transactions, to buyers and investors on the other. Its purpose is to ensure fairness and disclosure. Rubin v. United States, CCH Fed. Sec. L. Rep. ¶ 97,818 (U.S. S. Ct. 1981); see also Jacobs, The Impact of Rule 10b-5, supra, § 6. Section 10(b) and Rule 10b-5 are to be

liberally construed to effectuate these purposes. Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017 (6th Cir. 1979) and cases cited therein. If the opinions of the trial court and Ninth Circuit in this case stand, then defendants will control that flow of information and the substance of disclosure.

We respectfully submit that if a defendant knowingly and intentionally makes a decision to omit information, then that the defendant, not the investor should bear the risk and consequence of his decision. The defendant in effect makes a decision of nonmateriality, which should be subject to independent scrutiny by a court. If a court later finds the omission material, the defendant's knowing and intentional omission is sufficient to meet the scienter requirement and impose liability.

> [Defendant] contends that scienter requires an inquiry into "the

> defendant's state of mind--his subjective belief as to the legality of his action. . . ." . . . We strongly disagree. Knowledge means awareness of the underlying facts, not the labels that the law places on those facts. Except in very rare instances, no area of the law--not even the criminal law--demands that a defendant have thought his actions were illegal. A knowledge of what one is doing and the consequences of those actions suffices. We therefore hold that because [Defendant] knew the nature and consequences of his actions, he acted with scienter.

SEC v. Falstaff Brewing Corp., CCH Fed. Sec. L. Rep. ¶ 97,505 (D.C. Cir. 1980).

We respectfully request that the Court accept this petition and ultimately rule for the plaintiffs in this case.

DATED: February 12, 1981.

LeSOURD, PATTEN, FLEMING, HARTUNG & EMORY

and

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APPENDIX FOR MARX PETITION
FOR CERTIORARI

1. Amended Findings of Fact and Conclusions of Law

2. Order from Ninth Circuit denying petition for rehearing

3. Memorandum Decision from Ninth Circuit affirming District Court Decision

4. Stipulation and Order Setting Trial Date

5. Mr. Hoover's Address to the New York Society of Security Analysts

6. Trial Exhibit A (Front Cover and first two pages)

7. Transcript of Proceedings - William Hoover, Witness, p. 208

FILED
Dec. 29, 1978
Clerk, U.S. District Court
Central District of California
By Deputy

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

WILLIAM H. MARX and FLORENCE MARX, his wife, et al., Plaintiffs,	)	CV 72-1370-WMB
v.	)	AMENDED FINDINGS OF FACT AND CONCLUSIONS OF LAW
COMPUTER SCIENCES CORPORATION, Defendant.	)	

This matter was tried without a jury before the Hon. Wm. Matthew Byrne, Jr. Pursuant to a previous order, the trial was limited to the following issues:

With regard to William Hoover's speech to the New York Society of Security Analysts on January 23, 1970,

(1) Did Hoover make misstatements or omissions with the intent to deceive, defraud or manipulate investors?

(2) In the absence of a finding of intent to deceive, defraud or manipulate investors, did Hoover recklessly misstate or omit facts, and if so, is reckless behaviour actionable under § 10(b) of the Securities Exchange Act of 1934 or Rule 10b-5 thereunder?

The Court has considered the evidence presented by the parties and now makes its Findings of Fact and Conclusions of Law.

FINDINGS OF FACT

1. Plaintiffs William H. Marx and Florence Marx, his wife, claim money damages on their own behalf and on behalf of a class consisting of persons who purchased the common stock of the defendant Computer Sciences Corporation during the period January 23, 1970, through April 3,

1970, inclusive, in open market transactions, and who owned said stock on April 3, 1970, or thereafter. On January 6, 1975, an order was entered certifying this action as a class action.

2. The defendant Computer Services Corporation (hereinafter "CSC") is a Nevada corporation with principal offices located in El Segundo, California, within this district.

3. As of January, 1970, CSC had approximately 12,800,000 shares of common stock issued and outstanding. Its stock was listed on both the New York and Pacific stock exchanges. The common stock of CSC is a security within the definition of that term as set forth in § 3(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78(a)(10). CSC conducts business in many states and in several foreign nations. Since its organization in 1959, CSC has

engaged in the business of computer systems programing, computer facilities management and technical support, and the development and sale of proprietary computer-oriented systems. "Proprietary" systems were defined by Hoover as:

> products in which we have invested our funds and technical resources to create a product which we can then either sell or sell services or receive return from the investment which we have made, as opposed to contracted services, which are the development of systems under specific end item contracts, or support service contracts.

CSC's business "philosophy" stressed investment in and development of proprietary systems.

4. Four of the specific proprietary computer-oriented systems developed or in development by CSC by 1969 were: Computax, a computerized tax return system; Computicket ("CT"), a computerized ticket reservation system; Computer Applications, a series of package programs of standard

business accounting functions for use with the IBM 360 computer; and Infonet, a computer communication network providing time sharing information services using a central computer processer. CSC undertook the development of Computax in 1964, CT in late 1967 and Infonet in 1968. The financial results derived from these CSC systems were at all times reported on a consolidated basis by CSC.

5. In the fall of 1969, the New York Society of Security Analysts invited CSC to make a presentation to the society concerning the company. The chairman of the board of CSC, Fletcher Jones, requested William Hoover to make the address. At the time of the speech, Hoover was president of CSC, was informed on matters of CSC related to its finances, and had responsibility for the operations of CT.

Hoover personally prepared the address and reviewed it with some of CSC's top

management, including Mr. Jones. In connection with the preparation of the address, Hoover requested a fiscal 1970 earnings forecast from Robert Dossett, vice president for finance. The forecast was prepared by CSC's accounting department and reviewed by Hoover, Dossett and Jones prior to the speech. The accounting report utilized actual revenue and expense figures for the first three quarters of fiscal 1970, and projected figures for the fourth quarter. It was prepared using CSC accounting policy which deferred expensing the development costs of CT.

6. Hoover delivered the speech to the Society of Security Analysts in New York on January 23, 1970. Printed copies of the address were available to those in attendance. The speech took approximately thirty-eight minutes and was followed by a twenty-four minute question and answer period.

7. A copy of the address was mailed by CSC to the Wall Street Transcript, a financial journal. The subject matter of the speech, including the earnings forecast, was reported in the print media.

8. The address was intended by Hoover to provide a general picture or overview of CSC's operations, status and objectives. Hoover intended that those who heard, read or otherwise learned about the speech would believe that what was said regarding CSC was true and correct.

9. The speech delivered by Hoover depicted CSC as the leading firm in the field of computer software and information sciences. Emphasis was placed upon CSC's involvement in the development of proprietary products and services. The speech described in positive terms CSC's four proprietary programs, all of which were depicted as demonstrating the soundness of the company's philosophy of investing in

proprietary projects. Hoover pointed to the success of Computax as a prime example of the correctness of CSC's approach. After relating that CSC's $1.6 million investment in Computax had already resulted in a $5.4 million pretax return with a residual investment value of $20 million, Hoover noted that CSC was also involved in the development of CT and Computer Applications. In addition to these three proprietary systems, Hoover pointed to CSC's "time shared network services," known as Infonet, as a dramatic revolutionary approach with the potential for achieving a major position in a $2 billion market.

Hoover stated that since it was so near to the close of CSC's 1970 fiscal year (March 27), it was appropriate to compare CSC's performance with a forecast made three years earlier by Mr. Jones, concerning CSC's yearly earnings for fiscal 1970. Hoover stated, "I am pleased to say that

CSC expects to exceed the revenue and profit forecast with a total revenue of approximately $105 million and net income of approximately $1.00 per share on 12.8 million shares outstanding. . . . These estimated results compare with fiscal 1969 revenues of $64.9 million and earnings of 53 cents per share." In addition, Hoover said that CSC had budgeted $100 million over the next three years for the development of Infonet, and predicted revenues of $600 million by 1975 with a ten percent after-tax return.

The optimistic tone of the speech, including the representations, forecasts and plans for growth, conveyed an image of CSC as an established, progressive and expanding computer services company.

10. In the question-and-answer session following the speech, Hoover publicly stated that CT had not yet reached a full operational state and that CSC did not

contemplate an "appreciable" write-down of CT or Infonet development costs during fiscal 1970.

11. At the time of the address, Hoover was aware of facts which might bear upon the assertions, predictions and opinions contained in the speech. Among these were the facts that CT had not met all internal projections; that CT had lost First National City Bank as a prospective customer; that difficulties had been encountered in getting equipment operational and installed; that CSC had not procured capital to finance some proprietary products; and that CSC had considered selling one-half of its ownership of CT. He was also aware of the accounting treatment used for development costs of CT.

12. CSC had an accounting policy of deferring the expensing of development costs of proprietary projects until the project became "operational." Such costs

were capitalized and thus treated as an asset on CSC's balance sheet. After the project became operational, CSC would write down the capitalized (previously deferred) development cost and commence to expense current costs.

13. The above accounting policy was utilized for the development costs of CT. In April, 1969, in a prospectus for a secondary offering of stock, CSC announced that it planned to begin current expensing of CT's development costs as of September 1, 1969. In August, 1969, CSC decided to postpone by one month the expensing procedure. In September, 1969, in a prospectus for a public debenture offering, CSC advised that current expensing would commence October 1, 1969. Subsequently, CSC sought approval from Touche, Ross and Co., its accountants, for the continued

deferral of the development costs until August, 1970. This approval was obtained two days before Hoover's address.

14. CSC filed an 8-K report with the Securities and Exchange Commission on January 28, 1970, disclosing continuation of the deferral of CT's development cost.

15. CSC never commenced to expense CT development costs. This continuation of the deferral of development costs was consistent with CSC's announced accounting policy because CT never became "operational."

16. In late November or early December of 1969, CSC management had renewed CT and, even though it was a high risk, high capital project, decided to "enthusiastically" continue with CT. The activities of promoting and implementing the CT system proceeded without pause, and involved an expenditure of approximately $500,000 per

month, throughout the period of January 1, 1970, to April 2, 1970.

17. At the time of Hoover's address, CSC had not determined to discontinue CT nor was the subject of such discontinuation under consideration. At that time, CSC contemplated that CT would be operational about August, 1970.

18. In the last week of March, 1970, Hoover and Jones began to evaluate the possible discontinuance of CT. On or about April 2, 1970, CSC decided to discontinue CT. The decision was a matter of business judgment based upon the beliefs that CSC should not go forward with both CT and Infonet and that the latter was a more successful project.

19. At the time of Hoover's address, neither Hoover, Jones nor CSC knew or had reason to believe that CSC was going to discontinue the operation of CT.

20. Upon the discontinuance of CT, CSC wrote off CT's deferred development costs of approximately $13 million. As a result, these development costs became fiscal 1970 expenses for CSC.

21. The failure of CSC to realize earnings of "approximately one dollar per share" as forecast was caused by the discontinuance of CT and the resulting write-off of CT's capitalized development costs.

22. The write-off of CT's capitalized development costs caused a reduction of CSC's fiscal 1970 earnings of 47 cents per share. The actual earnings per share for fiscal 1970 were 41 cents.

23. Two other events contributed to the failure to realize the $1.00 earnings forecast. First, at the time the forecast was prepared and the speech delivered, CSC anticipated that it would acquire Commonwealth International, Inc. and add its

earnings to CSC's earnings, but the acquisition never closed. Second, at the time the forecast was prepared and the speech delivered, CSC intended to amortize the depreciation of certain items in its proprietary projects over a long period, but CSC subsequently decided to accelerate the depreciation. If the acquisition had been completed and the long-term depreciation taken, CSC would have earned in fiscal 1970 an additional ten cents per share.

24. The $600 million projection of revenues for 1975 was an amount "extrapolated" by Hoover based upon his current knowledge of CSC and its proprietary projects.

25. At the time of the address, Hoover was aware of, but did not include in his speech, the facts discussed in these findings that related to his assertions, predictions and opinions about CSC. Those

facts were not included because Hoover, in good faith, did not believe they were relevant to an accurate evaluation of the company's status and performance at that time.

26. Hoover's belief that the omitted facts did not render his speech misleading was not unreasonable.

27. The omitted facts did not render Hoover's assertions and predictions regarding CSC's future performance unreasonable.

28. Hoover's conclusion that the omitted facts were not relevant to CSC's status and performance was not reckless behavior. Hoover's belief that the speech, taken as a whole, gave an accurate picture of CSC was based upon a good-faith assessment of the company's current position and was not reckless behavior. In the address, Hoover was not oblivious to the dangers of omitting relevant facts, but rather made a

good-faith effort to portray CSC accurately.

29. In the address, Hoover did not make misstatements or omissions with the intent to deceive, defraud or manipulate investors.

30. In his address, Hoover did not recklessly misstate or omit facts. His behavior was not reckless.

31. Hoover's address was prepared and made in good faith and was neither fraudulent in purpose nor reckless.

32. Any Conclusions of Law to the extent they are deemed to be Findings of Fact are incorporated into these Findings of Fact.

CONCLUSIONS OF LAW

1. Any Findings of Fact to the extent they are deemed to be Conclusions of Law are incorporated into these Conclusions of Law.

2. This court has jurisdiction over the subject matter and parties.

3. Defendant CSC is not liable under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), or Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5. See Ernst & Ernst v. Hochfelder, 96 S.Ct. 1375 (1976).

4. Defendant is entitled to judgment herein, dismissing the Plaintiffs' Complaint, Amended Complaint, and Second Amended Complaint with prejudice, and awarding the Defendant its taxable costs.

DATED: Dec. 27, 1978.

s/
Wm. Matthew Byrne, Jr.
United States District Judge

FILED
Nov. 14, 1980
Richard H. Deane
Clerk U.S. Court of Appeals

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

WILLIAM H. MARX and FLORENCE MARX, his wife, Plaintiffs-Appellants,	)	No. 78-3014
	)	No. 79-3046
v.	)	DC# CV 72-1370-WMB
COMPUTER SCIENCES CORPORATION, Defendant-Appellee.	)	ORDER

Before: SCHROEDER and FERGUSON, Circuit Judges, and MacBRIDE,* District Judge

The panel as constituted in the above case has voted to deny the petition for rehearing. Judges Schroeder and Ferguson have voted to reject the suggestion for a rehearing en banc, and Judge MacBride has recommended rejection of the suggestion for rehearing en banc.

*Honorable Thomas J. MacBride, Senior United States District Judge, Eastern District of California, sitting by designation.

The full court has been advised of the suggestion for en banc rehearing, and no judge of the court has requested a vote on the suggestion for rehearing en banc. Fed.R.App.P. 35(b).

The petition for rehearing is denied and the suggestion for a rehearing en banc in rejected.

FILED
Sep. 8, 1980
Richard H. Deane
Clerk U.S. Court of Appeals

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

WILLIAM H. MARX and FLORENCE MARX, his wife, Plaintiffs-Appellants,	)	No. 78-3014
	)	No. 79-3046
v.	)	DC# CV 72-1370-WMB
COMPUTER SCIENCES CORPORATION, Defendant-Appellee.	)	MEMORANDUM

Appeal from the United States
District Court for the Central
District of California
Wm. Matthew Byrne, Jr., District Judge,
presiding
Submitted May 6, 1980

Before: SCHROEDER and FERGUSON, Circuit Judges, and MacBRIDE,* District Judge

Plaintiffs appeal from the district court's dismissal of their securities fraud claims, § 10(b) of the Securities Act of 1934, 15 U.S.C. § 78j(b) (1971); and Rule

*Honorable Thomas J. MacBride, Senior United States District Judge, Eastern District of California, sitting by designation.

10b-5, 17 C.F.R. § 240.10b-5 (1979), after a bifurcated trial on the issue of scienter only. Because we do not find that the district court's findings were clearly erroneous, we affirm.

Plaintiffs allege that investors were misled about the profitability of the defendant Computer Sciences Corporation (CSC) because of misrepresentations and omissions in an address to the New York Society of Security Analysts by William Hoover, then vice-president and a director of CSC. Another panel of this court fully set forth the facts of this case when it reversed the entry of summary judgment for defendant. Marx v. Computer Sciences Corp., 507 F.2d 485 (9th Cir. 1974). We held then that there were disputed factual issues concerning the truthfulness of the corporation's earnings forecast and the culpability of defendant for omitting to disclose developmental problems with the

corporation's subsidiary, Computicket (CT).

After trial, the district court found that Hoover believed that what he said was accurate and that he had made a good faith effort to portray CSC accurately. In addition, the court found that Hoover's belief that the speech was accurate was not reckless. Addressing Hoover's omissions, the court found that Hoover did not know or have reason to know at the time of the speech that CSC would later decide to abandon CT, but that Hoover did omit known facts relating to his predictions about CT. The court found, however, that Hoover believed that the speech was not misleading and that he omitted the facts in the good faith belief that they were not relevant to an accurate evaluation of the company's performance at that time. The court further concluded that Hoover's belief that

the speech was accurate was not unreasonable. In light of the foregoing findings, the court entered judgment for defendant.

Plaintiffs urge reversal on two grounds: (1) that the district court's findings are clearly erroneous; and (2) that the court's finding that Hoover made knowing omissions supports liability even if Hoover believed that his speech was an accurate portrayal of the company's financial picture, so long as the omitted facts were material.

While the evidence might support different conclusions with respect to Hoover's good faith beliefs in the accuracy of his speech, we cannot say that the trial court's findings are clearly erroneous. Fed. R. Civ. P. 52(a); United States v. United States Gypsum Co., 333 U.S. 364 (1948).

Plaintiffs' second argument fails, as well. It is true, as plaintiffs argue,

that knowing misconduct constitutes scienter. Aaron v. SEC, 48 U.S.L.W. 4609 (June 3, 1980); Spectrum Financial Cos. v. Marconsult, Inc., 608 F.2d 377 (9th Cir. 1979), cert. denied, 48 U.S.L.W. 3733 (May 13, 1980). The district court here, however, found that defendant was not guilty of knowing misconduct. All the cases plaintiffs cite in support of finding scienter despite a belief in the accuracy of the speech actually involve misrepresentations or omissions where the allegations were that the defendants knew or should have known they were misleading investors. Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017 (6th Cir. 1979); Zweig v. Hearst Corp. 594 F.2d 1261 (9th Cir. 1979); Nelson v. Serwold, 576 F.2d 1332 (9th Cir.), cert. denied, 439 U.S. 970 (1978); Rolf v. Blyth, Eastman Dillon & Co., Inc., 570 F.2d 38 (2d Cir.), cert. denied, 439 U.S. 1039 (1978); Sundstrand Corp. v.

Sun Chemical Corp., 553 F.2d 1033, (7th Cir.), cert. denied, 434 U.S. 875 (1977); Herzfeld v. Laventhol, Krekstein, Horwath & Horwath, 540 F.2d 27 (2d Cir. 1976); Wheat v. Hall, 535 F.2d 874 (5th Cir. 1976). We find only one case directly supporting plaintiffs' argument, holding that "knowledge of the falseness of the impression produced by the statements or omissions made is not required under Section 10(b) of the Act." Myzel v. Fields, 386 F.2d 718 (8th Cir. 1967), cert. denied, 390 U.S. 951 (1968). The Supreme Court disapproved this decision in Ernst & Ernst v. Hochfelder, 425 U.S. 185, 192 n.12 (1976), where it rejected this standard as a negligence standard and required, instead, a showing of intent to deceive, manipulate or defraud, id. at 194.

Given the district court's factual findings, Hochfelder requires a judgment for the defendant.

The decision of the district is AFFIRMED.

IN THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

WILLIAM H. MARX and FLORENCE MARX, his wife, et al., Plaintiffs, v. COMPUTER SCIENCES CORPORATION, Defendant.	CIVIL NO. 72-1370-WMB STIPULATION AND ORDER SETTING TRIAL DATE

STIPULATION

The above parties, through their respective counsel of record, stipulate to the entry of the following order.

DATED August 11, 1976.

LeSOURD, PATTEN, FLEMING & HARTUNG

/s/
George M. Hartung, Jr.
Attorneys for Plaintiffs

BOGLE & GATES

/s/
Don Paul Badgley
Attorneys for Defendant

O R D E R

The Court having heretofore ordered that the trial of this case be bifurcated, it is hereby

ORDERED that the trail of this case, as to the issue of scienter only, shall commence in this Court on Tuesday, November 30, 1976.

DONE IN OPEN COURT this ___ day of August, 1976.

United States District Judge

Presented by:

BOGLE & GATES

/s/
Don Paul Badgley
Attorneys for Defendants

LeSOURD, PATTEN, FLEMING, & HARTUNG

/s/
George M. Hartung, Jr.
Attorneys for Plaintiffs

An Address to
The New York Society
of Security Analysts

by

William R. Hoover
President
Computer Sciences Corporation

January 23, 1970

I am most pleased to be here today to discuss Computer Sciences Corporation with you. In this presentation I will attempt to amplify some of the basic philosophies that have resulted in CSC's growth and capability as the leading firm in the computer software and information sciences field, and discuss those factors that will lead to continued growth in the future.

First, in order to properly understand CSC, it is necessary to have a brief understanding of the evolution of the computer-based information industry as one of the most exciting and dynamic sectors of the economy. The computer industry emerged as a recognized force in the early 1950's and has since developed as a major factor in essentially all scientific and business activities. Through the first half of the 1960's, the greatest emphasis in the industry was on the establishment of computer hardware technology and in the

achievement of rapid growth in the computer hardware business sector. In the early 1960's the independent software and computer services industry began to emerge as a significant factor in the over-all industry, as both manufacturers and users of computers came to realize the importance of software in putting the machine to effective use. By the end of the decade the importance of software as the essential and critical element in utilization of the computer hardware power was firmly established, and the position of CSC as the leading software company was well recognized.

The critical importance of software to the effective use of the computer hardware capability in the latter half of the 1960's led to the creation of a market for applications software packages. The prospects for the rapid expansion of this market appear very promising.

In the late 1960's, revolutionary developments in both hardware and software also provided the proper technical basis for the establishment of the time-sharing information network services. This business sector is now recognized as the most rapidly growing part of the over-all computer-based information industry. Its potential for future growth appears to be limited only by the proper application of software technology to create the systems and applications packages required to provide specific services to the various industrial sectors of the business community. Due to the many ramifications of this field of activity, I will discuss it in greater detail later.

It is in these over-all business areas that CSC has established its capability and in which it looks forward enthusiastically to future growth and accomplishment.

Computer Sciences has achieved its position of leadership in the rapidly evolving software and information technology area by deliberate application of two basic business philosophies. First, that the basis for long-term business success in the information field must be the establishment of a strong, properly managed technical organization capable of undertaking the development of the most complex information system. Second, that such a technical organization could then be utilized to develop proprietary products and services which in turn could yield significant revenue and earnings growth.

I will take a moment to discuss how we proceeded to implement each of these philosophies in the conduct of our business. In respect to our basic premise, we felt that it was essential that the organization have the technical breadth to undertake the responsibility for the full

systems development effort. The elements involved in such an effort include systems software, applications software, communications systems engineering, operations research, systems analysis, display systems engineering, and many related problem-oriented technologies. Such systems orientation and end-item responsibility - as contrasted to the so-called "body shop" approach to services - are extremely important. They have a significant bearing on the organization's ability to establish and retain a qualified technical staff, and on the evolution of proper management techniques which define information requirements and control the development process. In CSC's case, this orientation also provided the customer with a measurable end product delivered by CSC, and served to enhance CSC's posture as a company qualified to undertake the complete solution of an organization's most complex

information problem. The cogency of this basic principle is evidenced by CSC's emergence as the leader in this business sector in both size and technical capability.

CSC was formed in 1959 in recognition of the rapidly growing requirement for systems software as a basic adjunct to the computer hardware. The users of computers were making increased demands on the computer manufacturers to provide Fortran compilers, operating systems, Cobol compilers and related systems programs.

The very substantial shortage of personnel skilled in this field and the lack of capability of most manufacturers to develop these complex software systems provided a very favorable business environment for the establishment and initial growth of Computer Sciences. In response to the market's needs, CSC developed a unique company capability in systems

programming, which is now acknowledged as the most critical of all technologies in the development of advanced computer-based information systems. CSC has since developed more systems software than all other independent companies combined, and more than most computer hardware companies. CSC has made some of the more significant contributions to the advancement of the technical state of the art in compiler languages, operating systems design and compiler optimization, and is looked to by the computer manufacturers to undertake the development of highly advanced projects in this area. The company is currently working on systems software projects for most of the major computer manufacturers, including IBM, Univac, CDC and XDS.

Systems software continues to play a key role in the growth of CSC, and as I shall discuss later is an essential element in the establishment of a leadership role

in the area of time-sharing information networks. Moreover, the increasing importance of systems programming and CSC's expanding capability to deliver advanced software serve to further enhance the company's technical leadership in the industry.

As the application of computers expanded into real-time systems, management information systems and the use of complex integrated data bases, the range of technology required to successfully design and develop a complete system was extended considerably beyond the software area.

To meet these enlarged requirements, CSC began a methodical expansion in the breadth of its technical staff by internal growth and through a limited acquisition program. CSC began to expand its internal capabilities into the commercial and government applications areas, such as management information systems, inventory

control, command and control, and logistics. CSC strategy has been to develop the problem-oriented skills in each area of concentration, as well as the full range of skills in information technology, so that a capability to solve the complete computer-based problem is available to the customer. The correctness of this strategy is reflected by the company's internal growth and the range of major projects completed by CSC. Examples of these projects are an integrated management information system for a major oil company's production control, the Space Flight Operations system for on-line control of spacecraft in NASA's deep space program, an integrated management information system for AEC headquarters, and the development of a complete logistics support system for the U.S. Army. In addition, CSC recognized the potential for applying its broad technical resources to facility management and was successful

in obtaining such contracts as the AEC facility in the State of Washington in 1965, and the NASA Marshall Space Flight Center at Huntsville, Alabama, in 1966.

Recognizing the fact that computers and communications would be inseparable in the advancing information sciences field, CSC acquired two divisions of ITT in 1965. These divisions were engaged in the systems engineering of satellite communication systems and global data communication network systems, and were recognized as the leading non-hardware producing systems engineering group in the communication field. They have since been integrated into the company's Systems Group, a multi-division organization and have contributed to the total systems engineering capability of CSC and to the company's subsequent growth.

Other acquisitions in the problem-oriented technologies, such as the acquisition

of City Planning Associates in 1968, extended CSC's problem-solving capability into new areas of significance to future growth. City Planning is one of the nation's leading consulting organizations in problems dealing with urban planning and transportation systems. As such, it represents a necessary capability in effectively applying today's technology in those areas. Through City Planning, CSC is providing solutions to the complex and pressing problems associated with urban blight and the stagnation of our cities. The requirements of this field enable us to look forward to significant growth through the application of CSC's experience in simulation, data base development and model development.

CSC's most recently announced acquisition, the Commonwealth Services companies, is scheduled for closing later this quarter. Commonwealth provides extensive

capabilities in the areas of management consulting and engineering. Its services include corporate planning, studies of economic and technical feasibility, transportation economics, regional transportation planning, and studies of highway, air, rail and marine transportation systems. Still other activities include the planning and engineering of systems related to the generation, transmission and distribution of power.

Commonwealth is a well-established organization in the public utility, transportation and process industries sector. These same industries represent a large market for the application of information sciences technology and time-sharing network services. Consequently, Computer Sciences' association with Commonwealth will considerably enhance CSC's total capability to serve these industries.

It is also worth noting that in the process of expanding its technical base, CSC has been careful to retain a flexible organizational structure which enables it to apply its total capability effectively to new areas as they emerge. As a result of this structuring, elements of the company can draw freely and quickly upon CSC's total resource in disciplines, skills and specialties. Thus responsiveness becomes yet another, though intangible, capability.

The results of the last 10 years' attention to building this comprehensive organization is a technical base which enables CSC to undertake solutions to the most difficult technological problems involved in the gathering, communicating, processing and displaying of information for industry and government. The future software requirements of industry in this sector are well recognized in terms of

total market potential, often estimated to be $21 billion in 1975. The share of this potential market to be captured by the independent software companies is forecast to grow from the current level of $1 billion per year to $3 billion per year in 1975. CSC is confident of its ability to continue its role as a major factor in this exciting growth area of the information field and to continue its growth in this sector of the business.

As I indicated earlier, the second basic business philosophy that has distinguished CSC was an early recognition that having the leading technical organization in the computer software field could lead to a significant growth in revenues and earnings if proprietary products were developed and marketed on either a product-oriented service basis or on an individual package product basis. It was recognized that the normal assumption of business risk

would be involved in financing the marketing research and product development of these proprietary services and systems. However, Computer Sciences was convinced that the opportunities for profit were so significant, as compared with selling contracted services for systems development, that the risk and investment were more than justified. In accordance with this business philosophy, CSC undertook the development of the Computax system in 1964.

Computax was developed and offered as a service to the accounting profession to provide the computer preparation of virtually any kind of individual income tax return. CSC investment in Computax was approximately $1.6 million at a time when the company's yearly revenue was $4 million. After operating the service for one year on an internal service basis, CSC sold controlling interest to Commerce Clearing

House to gain the advantages of an existing national marketing organization. Subsequently, Computax has been publicly traded, and CSC has received $5.4 million pre-tax return with a residual investment valued at approximately $20 million. This investment is, incidentally, carried at $219,000 on our balance sheet.

The success of Computax clearly established the correctness of CSC's philosophy on investment in proprietary projects. CSC then began the development of Computicket, a service which sells tickets to spectator events over a network of on-line terminals connected to a central computer with the inventory of seats to events in a given city. The company also commenced its application package activity with the development of a series of package programs for the IBM 360. These packages perform such standard functions as payroll, general ledger, accounts receivable,

personnel management, commercial loan and systems activities. An independent marketing and field service organization was established to sell these package products on a nationwide basis. The reception of the marketplace has been most encouraging and, based on the initial program, provides a significant area for future growth. CSC now has a product line of 12 packages in the field, all satisfactorily installed and operational with multiple clients, and all verifying the ability to design standard applications which can serve many different users.

In 1969, CSC announced the formation of its Information Network Division to undertake the company's most extensive proprietary effort to date: the development of a computer-communication network which would provide time-shared information services, using the Univac 1108 as the central computer processor.

This move was a logical extension of CSC's services and capitalized upon the company's unique software capability which I mentioned earlier. CSC, through its Systems Programming Department, had participated in the advanced technical developments that had taken place in time-sharing hardware and software. The company was well aware of the technological problems requiring solution and of the need to develop proprietary systems capable of meeting the market demand in this very large and rapidly expanding market.

Independent industry forecasts predict a business potential of more than $20 billion for these services in 1975, with a projected market penetration of some $2 billion. This market is identified as largely in the area of applications to the small to medium-size industrial and business organization.

CSC considers its time-shared network services, known as Infonet, to be a dramatic, revolutionary approach to the solution of information problems for small businesses. CSC's network will offer standard industry packages, with a complete system and procedures for their use on a per transaction basis, allowing the individual company to gain the competitive advantages of the most advanced computer technique without the significant investment in customized computer software or his own dedicated computer facility. Even though 50,000 computers are installed in the United States, only a small fraction of some four million business concerns has been able to afford the substantial investment required. The remainder are the major potential market for CSC's Infonet.

The achievement of a significant position in the network time-sharing market requires the proprietary investment in a

complete set of systems software to control the operation of the network and provide the necessary utility programs for the application packages. This systems software capability is not adequately available from any of the hardware manufacturers, although several manufacturers have hardware capable of solving the network problem. Furthermore, in addition to the systems software, the definition and development of the standard applications packages must be carried out as a proprietary effort. Due to CSC's capabilities in systems software and the full breadth of its technical resources in communications, applications software and other related technologies, the company concluded that this area provided high potential for proprietary investment and resulting revenue and profit growth.

CSC has budgeted an investment of $100 million over the next three years for the

development of its information network, including $50 million for the purchase of computer hardware and $50 million for the development of proprietary software. Initial revenue from the first phase of the network will be received in the current quarter. CSC is confident it will attain a major position in the industry, and anticipates holding a 15 percent share of the total market in 1975. CSC's decision to invest in a time-sharing network can be likened to IBM's decision to enter the electronic data processing hardware market in the early 1950's. The consequences of IBM's decision are well known to all of you.

I should like to emphasize that, while the achievement of a major position in this $2 billion market is dependent upon the commitment of a significant financial investment, an equally if not more important ingredient is the availability and

commitment of a properly managed, proven technical organization to implement the proprietary systems. CSC has the financial strength and is uniquely qualified with technical and management capabilities to meet these requirements.

CSC has now completed its test period of the new network. More than 100 companies have been actively participating in our pilot testing, and we look forward to most of these organizations staying with the service when it goes on a revenue basis next week. Infonet begins operations Monday in New York City, Washington, D.C., Los Angeles and San Francisco; by the end of March, service will be provided in Chicago, Detroit, Philadelphia and Hartford, Connecticut, and branch offices will be added in other cities throughout the year. The initial Infonet computers are installed at Silver Spring, Maryland, and El Segundo, California. These will be

followed by computer installations in New York, Chicago and Dallas.

Infonet will provide generalized applications for the manufacturing organization, the wholesale distributor, the construction engineering firm and the electric utility company. The service will also provide extensive packages for financial analysis, general scientific analysis, small business data processing, and statistical analysis.

In concluding my remarks, I would like to briefly discuss a few aspects of CSC's financial performance. Approximately three years ago, Fletcher Jones, Chairman of CSC, forecast revenues for the current CSC fiscal year of $100 million with a net income of 10 percent of revenue. While it will not be the policy of the company to forecast yearly earnings in the future, since it is so near the closing of our fiscal year (March 27) it is appropriate to

compare our performance with Mr. Jones' forecast. I am pleased to say that CSC expects to exceed the revenue and profit forecast with a total revenue of approximately $105 million and a net income of approximately $1.00 per share on 12.8 million shares outstanding.

Internally generated growth is expected to raise fiscal 1970 revenues to $85 million, while the pending acquisition of Commonwealth will contribute additional revenues of approximately $20 million. These estimated results compare with fiscal 1969 revenues of $64.9 million and earnings of 53 cents per share.

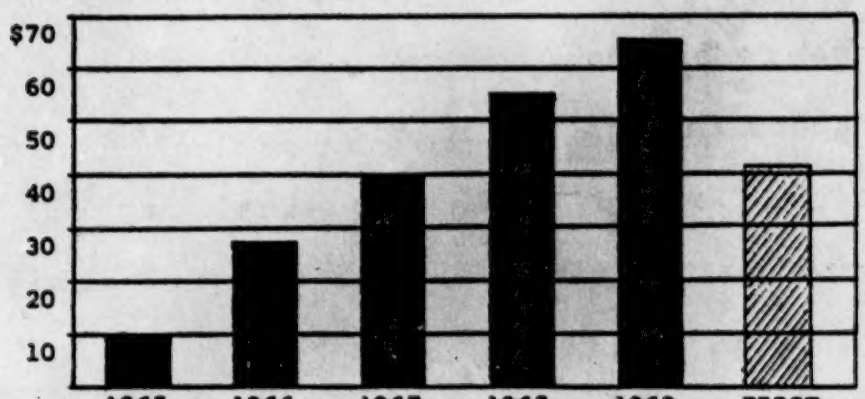
Finally, a few words about our plans for future growth. Based upon our established position in the information technology field, our increased attention to commercial market opportunities, and the expected returns from Infonet and other proprietary investments, CSC's plans call

for a growth to $600 million by 1975 with a 10 percent after-tax return on revenue. I am sure you will all agree that these goals are demanding; however, the revolutionary nature of the information network services business and CSC's technical capability give us confidence that we will achieve these forecasts.

I look forward to standing before you at the close of 1975 and again reviewing CSC's performance.

REVENUES

MILLIONS

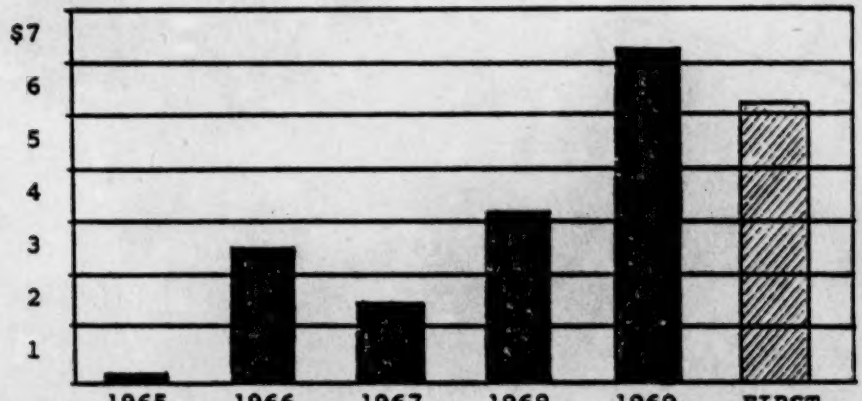


FISCAL YEARS

	1965	1966	1967	1968	1969	FIRST HALF 1970
REVENUES	11.2	29.1	40.2	56.0	65.9	40.8

NET EARNINGS

MILLIONS



FISCAL YEARS

	1965	1966	1967	1968	1969	FIRST HALF 1970
EARNINGS PER SHARE		0.24	0.17	0.31	0.53	0.44

Computer Sciences Corporation
Century City, Los Angeles, California 90067

Systems Group
Falls Church, Virginia

- Systems Division
- Atomic Energy Division
- Field Services Division
- Urban Planning Division

Information Network Division
El Segundo, California

Development Division
El Segundo, California

Computer Sciences International, S.A.
Brussels, Belgium

Computer Sciences Canada, Ltd.
Toronto, Ontario, Canada

Computicket Corporation
New York, New York

Computer Sciences Institute
El Segundo, California

Computer Sciences Leasing Company
Los Angeles, California

A-58

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FOSTER & MARSHALL INC.

COMPUTER SCIENCES CORPORATION

ANNUAL REPORT

1969

TRIAL EXHIBIT A

TO THE SHAREHOLDERS OF
COMPUTER SERVICES CORPORATION

Fiscal 1969 results set new financial records for the Company. Total revenues were $64,883,000, compared with $56,017,000 for the year before, while net earnings in the period rose to $6,393,000 as compared with $3,384,000 for fiscal 1968. Based on 4,798,785 average shares outstanding, earnings were $1.33 per share for 1969 versus $.78 for 1968, when there were 4,341,570 average shares outstanding. These results include $387,000 of net income, equal to $.08 per share, attributable to the sale of securities during 1969, while 1968 results are restated to account for an acquisition on a pooling-of-interests basis. On a directly comparable basis, which accounts for differences in the surtax rate and in the number of outstanding shares, operating earnings for the period were almost double those of

fiscal 1968, the second consecutive year in which this result has been achieved. Prospects are excellent for a continuation of this trend for fiscal 1970.

The results for fiscal 1969 demonstrate the presence of a pronounced trend toward higher profit margins on revenue. This trend results from the shift of business content from predominantly government support activity, characterized by low profit rates, toward higher profit nongovernment work. This is one direct result of the Company's past investments in expansion of its commercial activities and development of proprietary products and services. Such products and services received continued attention and emphasis during fiscal 1969, and it is therefore expected by management that increased benefits due to higher commercial and proprietary content in the business mix will be realized in future periods.

Progress on previously announced proprietary efforts continued satisfactorily during the year, and management is quite optimistic regarding the prospects of these. Several new program packages were developed for sale to computer users, and this market began to respond quite positively to the Company's efforts by year's end.

COMPUTICKET, the Company's computer-based instant ticketing service for sports and entertainment events, became operational during the year, and its services are now being offered in Los Angeles, New York, Philadelphia and Baltimore, in all of which public response has been most gratifying. Many major events and important outlets have contracted for COMPUTICKET service, and further expansion is programmed for fiscal 1970, during which the system is forecast to become initially profitable.

COMPUTAX, a service previously developed by the Company for the processing of individual tax returns, was operated successfully and at a substantially increased profit rate by COMPUTAX Services, Inc., in which the Company holds a 38% equity position.

The Information Network Division was formed by the Company during the year to undertake the development and operation of the Company's planned nationwide network of computers, through which CSC will offer communications-based information and computation services. Much of the initial software and marketing development for the network have been accomplished at this writing, and the first computer is scheduled to become operational in Los Angeles in the summer of 1969. Computers will be added to the network at sixty- to ninety-day intervals thereafter. The network, to

be comprised of twenty large-scale computers located in principal cities throughout the country, is expected to be a major source of revenues and earnings for the Company in future years and, as such, is receivng the best the Company can bring to bear in terms of management, financial and technical resources.

Computer Sciences International, the CSC European subsidiary which is 75% owned by CSC and 25% owned by the Philips Company of the Netherlands, became profitable during the year for the first time since its formation, and is expected to continue a positive growth trend for future periods. Computer Sciences Canada was reorganized to include participation in that subsidiary by Canadian Pacific Railway Company and Canadian National Railway Company. CSC retains 49% of the equity of the Canadian affiliate and expects that the combination

with two of Canada's most important organizations will prove an accelerating factor in the development of the Canadian market for the Company's products and services. Additional foreign markets are being studied as of this writing, and it is expected that announcements of plans relating to these will be forthcoming during the next few months.

In March 1969, the Company announced a reorganization of its operating units. The Computer Sciences Division and the Communications & Systems Division were merged into a major new organization designated the CSC Systems Group. The Systems Group, headed by CSC vice president and director Alvin E. Nashman, will be responsible for the Company's operations in the contracted services and support sector, the areas which have traditionally contributed the preponderance of the Company's revenues. Other separate organizations

within CSC will be such as the Information Network Division, Computer Sciences Institute, Computer Sciences Leasing, Computer Sciences International and Computicket Corporation, all of which will report, along with the Systems Group, to CSC director William R. Hoover, who was named executive vice president as part of the realignment. It is expected that the new organization will enable the Company, through the Systems Group, to more effectively apply its capabilities to the broadest and largest problems of systems technology, while the separation from contracted business of commercial and proprietary activities will allow maximum management visibility of these important functions.

In November 1968, Computer Sciences Corporation became the first company in its field to be listed on the New York Stock Exchange. In May 1969, the directors voted

a five-for-two stock split, to become effective in June 1969. This action, the third stock split since the Company's initial offering somewhat over five years ago, was taken to effect broader distribution of the Company's securities and to thereby increase the number of those who are interested in the Company and its affairs.

On April 16, 1969, the Company was ten years old. CSC's first decade has seen the organization grow from four to nearly four thousand employees, while the Company achieved a record of technical and financial success unrivaled in its field. The accomplishments of the first decade are more than equalled by the opportunities of the next. Equipped now with fundamental strength in management, technical capability and financial resources, we expect that CSC will establish itself during the next

few years as a leading factor in the rapidly emerging and immensely promising information sciences field. Management gratefully acknowledges the Company's debt to its employees, customers and shareholders for their continued support during its first ten years, and pledges its enthusiastic pursuit of the opportunities which are so clearly a part of the Company's future.

/s/
Fletcher Jones,
President and Chairman

of putting the business into perspective.

THE COURT: The easiest way to communicate?

THE WITNESS: Yes.

BY MR. ARMSTRONG:

Q At the time you gave the speech did you have the opinion that the --

THE WITNESS: May I just amplify one additional point, your Honor?

THE COURT: Sure.

THE WITNESS: I think he asked a question about security analysts. These are professional people who would not necessarily hop on just the earnings forecasts. Certainly newspaper reporters would, if you can differentiate between a security analyst and a newspaper reporter.

THE COURT: When you really get down to the financial condition of the company, though, taking your speech as a whole, the

earnings forecast is about the only place you really talk about the financial condition of the company, isn't it?

THE WITNESS: Financial condition in terms of specifics, but I think you will find that a security analyst would be equally concerned with problems and investments in proprietary programs and description of the business as a whole.

TRANSCRIPT OF PROCEEDINGS -
WILLIAM HOOVER - WITNESS